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Interview with Margaret Thatcher:

European Union is dead—good riddance

October 26, 1992 Four Dollars

Forbes

Stock promoter Robert Brennan

WHY CAN'T THEY STOP HIM?

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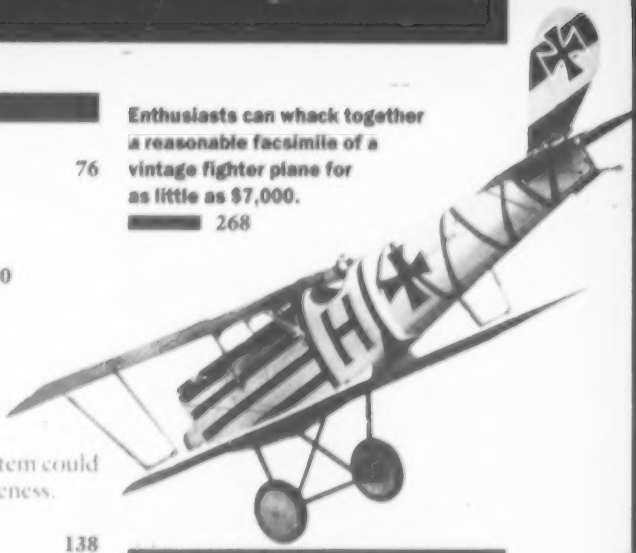

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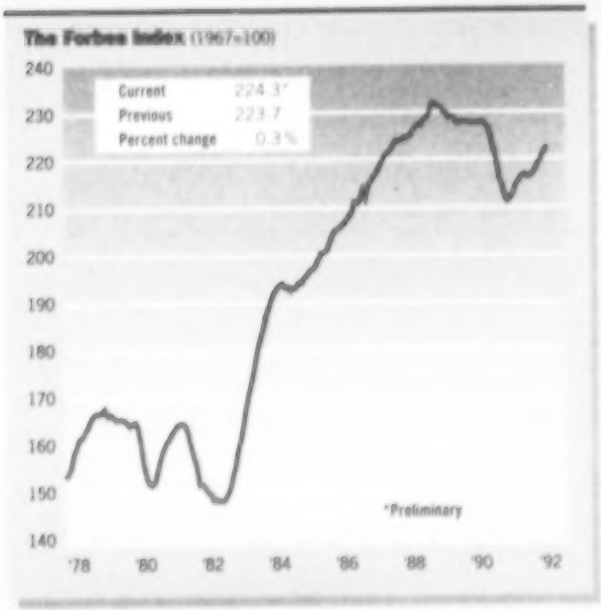
THE FORBES INDEX

BY ROBERT ROSENSTEIN



Don't expect much improvement in the economy in the fourth quarter, says Robert Dederick, chief economist at Northern Trust Co. His bleak assessment is apparently shared by the American public: The Conference Board's consumer confidence index has fallen three months in a row, to its lowest level since March 1992. The Forbes Index eked out a 0.3% gain for August (preliminary figure). Contributing: a 1.4% rise in the 12-month moving total of new housing starts, and a 1.7% fall in the 6-month moving total of new unemployment claims.

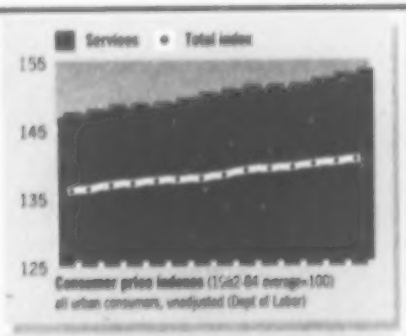
Other key rates	Source	Status
Prime rate	Chase Manhattan Bank	6.0%
Auto sales year to date vs. 1991[1]	Ward's Automotive	0.7%
Index of leading indicators Aug vs July	Dept of Commerce	-0.2%
Trade balance 12 months ended July 1992	Dept of Commerce	-$72bil
All-commodity producer price index Aug vs July[2]	Dept of Labor	-0.2%
GDP 2nd quarter vs 1st—annualized growth	Dept of Commerce	1.4%
M2 (3-month change)—annualized growth[3]	Federal Reserve	-0.3%

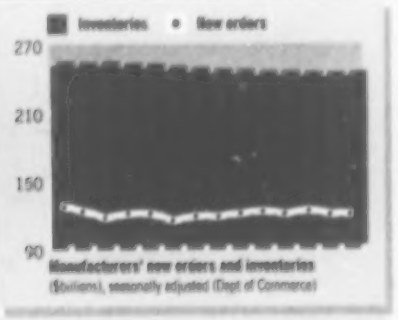
[1] U.S.-based manufacturers, excludes imports, as of 9/20/92. [2] Wholesale goods. [3] Includes M1 (public currency and checking deposits) plus savings accounts and money market funds.

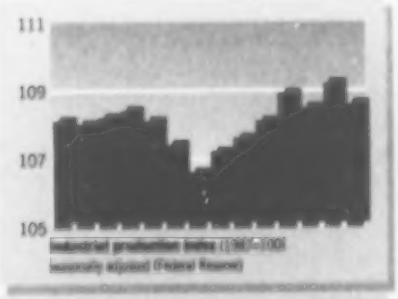
Index components

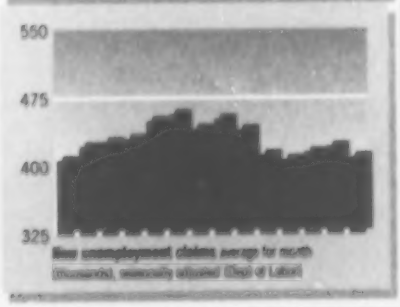
The Forbes Index is a measure of U.S. economic activity composed of 8 equally weighted elements: The cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total industrial production, new housing starts, personal income, new claims for unemployment compensation, total retail sales, total consumer installment credit.

To measure these 8 elements, Forbes monitors 10 series of U.S. government data. The last 14 months' data for each series are presented below.







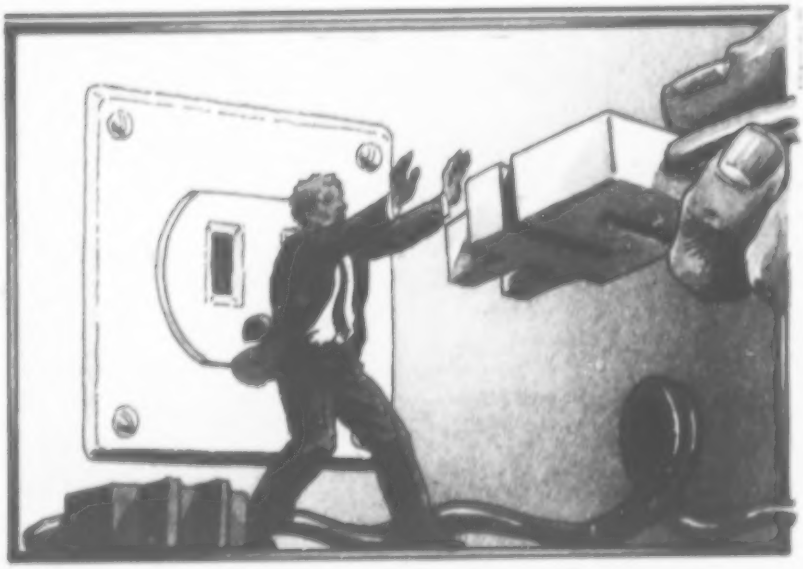


J A S O N D J F M A M J J A J A S O N D J F M A M J J A J A S O N D J F M A M J J A

With regulators changing the rules of the game, more and more utilities are trying to lower their sales.

Demand-siders

By Paul Klebnikov



PACIFIC GAS & ELECTRIC plans to invest $2 billion this decade to encourage its customers to use electricity more efficiently. By giving out rebates and credits for the installation of better insulating windows, compact fluorescent lights, industrial motors with variable-speed drives and other energy efficient equipment, PG&E hopes to cut growth in electricity demand by 75%, or the equivalent of 2,500 megawatts of new capacity. To build that much generating capacity would cost around $5 billion at today's prices—assuming the plants could make it through the environmentalists' gauntlet.

PG&E is not alone. It is one of many electric utilities that are investing large sums in so-called demand-side management.

How do utilities get a return on these investments? That's a subject that's been debated since the 1970s energy crisis. Under pressure from conservationists, some 30 states, led by California, Oregon, New York, Massachusetts and Maine, have now changed utilities' rate structures to try to make demand-side investments as profitable as investments in new power plants. Many states now allow utilities to recover their demand-side investments by including them in the rate base, the same way a new plant would be included. In these cases the utilities must capitalize these expenditures and recover them over a period of years. In other states they are allowed to treat them as operating costs, and recover them immediately.

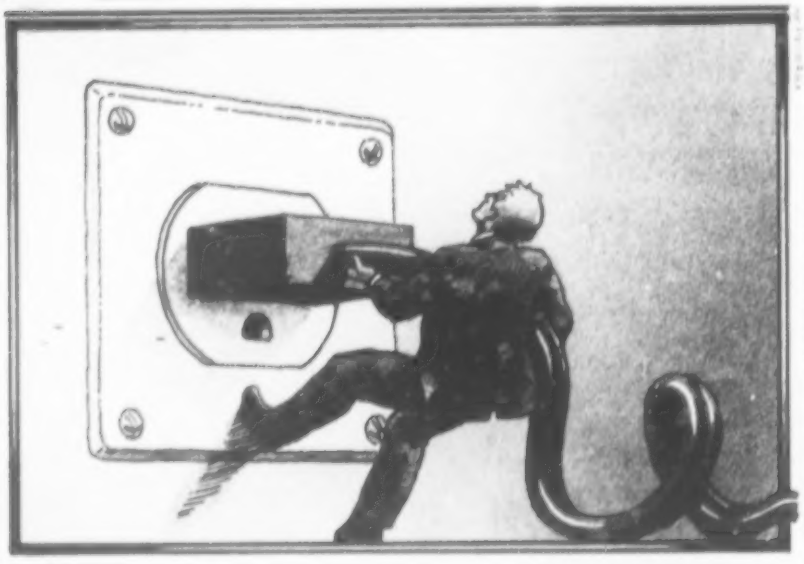
Since demand-side programs essentially decrease a utility's sales, many states allow utilities to make up for such "lost sales" by earning the same profits (though not all the revenues) they would have received if electricity demand had grown and been satisfied with new plants. Another popular approach, pioneered by California, is to calculate the savings on the average electricity bill resulting from the demand-reduction pro-

Demand-side management: when less is more

Company	DSM program costs ($mil)	"Profits"[1] ($mil)	DSM program "margins"	Operating revenue[2] ($mil)	Net profit[2] ($mil)	5-year ROE	Recent price	Latest 12-mo P/E	Yield
Consolidated Edison	$76	$38	33%	$5,873	$530	12.5%	31¼	12.9	6.0%
New England Electric	92	15	14	2,094	180	11.7	38⅞	12.8	6.0
New York State Elec & Gas	26	17	40	1,556	148	11.4	31⅝	13.3	6.6
Niagara Mohawk	45	18	29	3,383	243	8.1	19⅝	12.1	4.1
Pacific Gas & Electric	185	45	20	9,778	1,026	11.5	31⅛	12.0	5.5
Puget Sound Power & Light	42	17	29	957	113	13.1	26⅜	12.5	6.7
SCECorp	107	4	4	7,503	703	14.4	45¼	12.9	6.2

[1]Compensation for lost sales and profit incentives. [2]Fiscal 1991. Sources: Value Line via Lotus One Source; company data

Utilities are allowed to raise rates to cover the cost of demand-side programs, to compensate for lost sales and to earn an incentive pretax profit. The profit incentive/lost sales compensation often results in a large "margin" on the program. All utilities have different rules, but for many, DSM programs add significantly to overall profitability.



gram, and allow the utility to earn a portion of that—typically 15%—through rate increases. In other words, a utility that aggressively implements a demand-side program may end up with stagnant, or even falling, sales but more profits per dollar of revenues.

As a result of these incentives, utility demand-side programs are growing rapidly, though you wouldn't be able to learn this by looking at the financial statements. In 1990 utilities invested about $1 billion on demand-side programs. In 1991 the figure was about $1.5 billion; this year it will be even higher.

"There is a veritable stampede across the country [into demand-side investments]," says John Anderson, executive director of the Electricity Consumers Resource Council, an association representing companies like General Motors, Dow Chemical and Bethlehem Steel. Utilities on the East and West Coasts, facing the most pressure in siting new power plants and in getting the expenditures approved, have led the charge.

Some utilities have racked up nice profits on their demand reduction investments *(see table, p. 134)*. PG&E spent $185 million on its demand-side program in 1991, was allowed to recover those expenditures and get an additional $45 million in various pretax profit incentives—equivalent to a 20% pretax margin on the program. New York-based Consolidated Edison had a a 33% "margin" on its program. Note, however, that after this year, populist regulators in California and New York say they are going to crack down somewhat on those high margins, proving once again that no good deed should go unpunished.

Not everyone loves demand-reduction programs. Some consumers are unhappy with the rate increases that demand-side programs entail, even when the programs also result in lower average bills. Another criticism has come from Anderson, who argues that with a demand-side program a utility becomes a "taxing agency" that subsidizes some customers while raising rates for everybody. That is, consumers that are rewarded with rebates for making demand-reduction investments come out ahead at the expense of ratepayers in general. Anderson grouses that companies that have already invested their own funds in energy-efficiency improvements now have to pay higher rates to subsidize the same improvements for laggard companies.

But expect demand-side programs to continue to proliferate. The Edison Electric Institute estimates that over the 1990s demand side management will obviate the need for 24,800 megawatts of new electricity capacity, the equivalent of 72 coal-fired plants. In the long run, using power more efficiently is in everyone's best interests. ■

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Selling infant formula used to be a gentlemanly game of calling on doctors and hospitals. Now it's a cutthroat business.

Baby milk wars

By Marcia Berss

BRUTISH COMPETITION is breaking out in the $1.6 billion a year U.S. market for infant formula. The combatants: Abbott Laboratories, Bristol-Myers Squibb, American Home Products and Nestlé S.A.'s Carnation Co. Of the four, Nestlé/Carnation has the most to gain, Abbott the most to lose.

Infant formula used to be marketed solely as a pharmaceutical product. The producers' salespeople called on pediatricians, who recommended one product or another to young mothers, who bought whatever the doctors ordered at their local drug and grocery stores. At the request of the American Academy of Pediatrics, there was no direct consumer marketing of infant formulas; the pediatricians' group feared that advertising would encourage mothers to switch from breast feeding to using infant formulas. (The latter, agree pediatricians, are nutritionally inferior to mother's milk.)

This comfortable little marketing system was first shaken in 1988, when the federal government directed the states to buy all their infant formula from one manufacturer, to get lower prices. This was a serious shock. The states purchase about 35% of all formula via the Women, Infants and Children (WIC) program. The programs had allowed mothers to obtain whatever brand formula their doctors recommended. But suddenly, the formula makers found themselves competing directly—and on price—for WIC contracts.

Enter Carnation, which was purchased by Nestlé in 1985. Carnation had never been a factor in the infant formula business. But as competition flared after 1988, Carnation decided to get into the market. It did so by aggressively marketing its Good Start and Follow-Up formulas not only to pediatricians but also directly to consumers. Good Start and Follow-Up were essentially the same product as Abbott's Similac and Isomil, Bristol-Myers Squibb's Enfamil and Prosobee, and American Home Products' SMA and Nursoy. The only real difference: Carnation's product was a good deal cheaper.

Meanwhile, infant formula caught the eyes of trustbusters at the Federal Trade Commission, who wondered why there hadn't been more competition in the past. Last June the FTC charged that Abbott, Bristol-Myers and American Home had fixed prices for infant formula in government nutrition programs in 1990, and that Abbott and Bristol conspired not to advertise the product directly to consumers. American Home Products (with around 14% of the formula market) and Bristol-Myers Squibb (with 30%) immediately settled with the government. But Abbott Labs, with 50% of the market, is fighting the FTC's charges.

Whatever happens with the FTC suit, the new competition in the formula market is certain to hurt Abbott.

Winners and losers

Company	Recent price	Latest 12-month EPS	P/E	Total sales ($mil)	Baby formula sales ($mil)	Baby formula % of total sales	Baby formula market share	Price/cash flow	5-year ROE
Abbott Laboratories	27½	$1.38	19.9	$6,877	1,060	15.4%	50%	15.9	32.8%
American Home Products	64⅝	4.63	14.0	7,079	156	2.2	14	13.2	43.0
Bristol-Myers Squibb[1]	63	4.07	15.5	11,159	547	4.9	30	14.2	30.7
Carnation[2]	NA	NA	NA	7,000[3]	65	1.0	6	NA	NA

Sales figures are for 1991. U.S. market share data as of second quarter of 1992. [1]Includes Gerber Products sales. [2]A subsidiary of Nestlé USA. [3]Nestlé USA revenues. NA: Not applicable.

Sources: Value Line via Lotus One Source; Information Resources, Inc.

As the marketing of infant formula changes, Abbott Labs, with the most market share, also has the most to lose.

Carnation is pricing its formula 12% to 35% below Abbott's products—whereas a 16 ounce can of Abbott's Similac powder goes for $10, the same quantity of Carnation's Follow-Up costs around $6.50. And Bristol-Myers, which licensed the well-known Gerber Products name in 1989 to develop a consumer brand, is giving away coupons for free trial quantities of Gerber formula in order to build market share.

Prices in the big state-controlled WIC sector are really falling. Example: Oregon used to pay the manufacturers' full wholesale price for formula until sole sourcing cut its formula procurement cost to 56% of wholesale. This year Oregon and other states have allied for the first time to get yet lower prices, and in July Oregon began paying only 20% of wholesale. To offset these cuts, Abbott last year raised its consumer prices a big 16%.

Last year infant formula generated around 15% of Abbott's $7 billion in sales and around 20% of its operating earnings. But the competition has already pushed operating margins on Similac and Isomil from the 30% to 35% range (better than Abbott's drug and hospital supply units), down to 25% to 30%. Also worrisome: Abbott's share of the formula market has slipped from 55% to 50%. Its formula sales are growing at 3% a year, down from 10% a year through most of the 1980s.

Abbott executives say the company knows how to market drug products to doctors and hospitals. But they admit they don't have much expertise when it comes to selling directly to consumers. Abbott's handful of consumer goods—including Murine eyedrops and Selsun Blue dandruff shampoo—are also-rans in their markets. Abbott continues to market Similac and Isomil only to pediatricians.

What of Carnation, the company that ignited the baby milk wars? It has taken only a 6% share of the formula market, but one knowledgeable competitor expects that figure to climb rapidly. Gerber Products' Chairman Alfred Piergellini led Carnation's formula efforts before joining Gerber in 1989. Says Piergellini, referring to giant Nestlé: "Remember who's bankrolling Carnation. It doesn't have to be profitable for a long time. They are willing to invest." ■

Even the most crowded and competitive businesses offer opportunities to those who can develop some kind of an edge. In a service business, Osman Siddique figured out how to give extra service at no extra cost.

In the shadow of American Express

By Tatiana Pouschine

THERE ARE only 32 travel agencies in the country that generate more than $100 million in revenues. Big corporate business tends to go to travel industry giants like American Express, Carlson Travel, Thomas Cook, Rosenbluth and U.S. Travel rather than to small independents. It's tough breaking into this charmed circle.

But 42-year-old Osman Siddique is trying to do just that. His 16-year-old Washington, D.C.-based corporate travel business, Travelogue, Inc., generates $40 million a year in revenues and is growing rapidly.

Osman Siddique is living proof that even the toughest business offers opportunity for those who can find a unique approach.

One of nine children of a Bangladeshi ambassador and university president, Siddique broke with his family's mandarin tradition to become a businessman. It started when he needed money to pay for an American education. Working his way though Indiana University, he picked up trash at the football stadium and summers worked as a waiter, bartender and later on as captain at a posh restaurant in Washington.

In 1974 he was equipped with an M.B.A. and a flair for salesmanship that owed something to his diplomatic background, something to his restaurant experiences. He joined Metropolitan Life in Washington to help develop individual financial plans and made sales calls.

It was a start on the American ladder but not at all what Siddique wanted. Asking himself where he would be in 20 years, he answered: "I'd be an assistant vice president posted somewhere dull." He decided he would start his own business. In what? Well, he loved travel. In 1976 he scraped together $25,000 and started a travel agency.

Selling travel to the Indian subcontinent would have been the obvious route for someone with his background and experience, but Siddique felt it would be too limiting. Corporate travel offered promise, but the big accounts were sewn up by Thomas Cook and American Express. He decided to go after small corporate clients—not the $50 million account but the $300,000 account.

To live frugally he moved into the basement of his brother's Washington home (his brother was an economist at the World Bank) and rented office space right next to American Express. He hired a travel agent to handle the tariff books and write tickets while he hit the pavement drumming up business for Travelogue. He began with cold calls, using the Yellow Pages for names, walking into office buildings and pitching anyone

A new era of deregulated power production is giving growth stock fans a taste of the electric business.

Speculative utilities

By Manjeet Kripalani

THE HOT UTILITY stocks right now are not for widows and orphans. They are new issues from so-called independent power producers like fast-growing AES Corp. of Arlington, Va., which wholesales power to businesses and to other electric companies from six plants around the country.

No stodgy utilities, these. Independent power producers borrow heavily against long-term contracts with big power users to build efficient new plants. The companies aren't bound by federal regulation or state utility commissions in setting rates. With none of the overhead or regulation of a traditional utility, independents have a tremendous pricing edge.

What makes these stocks speculative is their high degree of leverage. Look at AES: Even after its initial stock offering in June 1991, debt to equity is roughly 10-to-1. That leverage gives this hot growth company a return on equity of 34%, even though its pretax return on capital (operating income divided by debt and equity capital, not counting capital tied up in partly built plants) is only 13%.

Leverage cuts both ways. AES got into trouble with a power plant it completed in 1986 for Houston Lighting & Power. The plant's electricity price is tied to the price of gas, which went down, and the plant isn't covering its interest costs. AES started out as an owner of the plant but is now just an operator.

Needless to say, companies like this don't pay dividends as normal utility stocks do. They need to hold on to every penny that comes in to reduce their debt ratios.

Of the country's 117 independent power producers, only a handful are public. But they are having a field day on Wall Street. In the past year and a half, three indies have raised $600 million in public stock and bond offerings. Over the next ten years, projects the Edison Electric Institute, independents will add some 35 gigawatts of generating capacity, almost half of what traditional utilities are planning to add. A gigawatt, or 1 million kilowatts, is enough power for a city of 500,000; coal-fired plants with that much power would cost $1.5 billion to build.

The independents are competing internationally against equipment powerhouses like Asea Brown Boveri and Westinghouse, which build and operate plants abroad. California Energy and Destec Energy raised a quarter of their funds overseas; AES is developing and operating generating plants in the recently privatized utility sector of the U.K. It is also developing plants in Poland, Hungary, Mexico and Oman.

But the biggest opportunity for growth will be right here. An upcoming amendment to federal utilities regulations will open up interstate power transmission lines to the independents. That means they will gain access to the utilities' wholesale customers, too. And utilities planning to add capacity will be required to accept supply bids from independents in competition with their own plants.

But keep the risks in mind. Some independents are betting on newfangled technology, such as fluidized coal and geothermal power. Consider, also, that independents tend to rely on a few large customers. Contracts are typically for long terms, but they leave buyers with certain outs, and suppliers with little negotiating power in case of a dispute. A heavily leveraged supplier simply can't afford to have a plant shut down for any length of time.

Some of these companies are trading at below-market price/earnings ratios, but they all are expensive in relation to revenues. AES, with 1991 revenues of $334 million, has a market cap of $905 million. Destec Energy, the former Dow Chemical subsidiary that raised $300 million in its 1991 initial public offering, has a market cap of nearly $1 billion, or two times revenues.

In short, while many of these power companies may turn out to be highly successful, their stocks are no bargains. ■

Independent power producers

Company	Revenue per kwh (cents)	Recent price	Book value per share	Earnings per share	Dividend	Book value of plant per kw
AES	5.8	20¾	$3.26	$1.07	$0.11	$1,253
California Energy	12.5	12⅜	4.34	0.83	—	1,280
Destec Energy	4.1	14¾	7.62	1.32	—	161
Magma Power	7.8	22¼	9.90	1.49	—	1,646

Note: All data for fiscal 1991, except Earnings per share, which is for latest 12 months.

These are all growth stocks—and, like most growth stocks, quite risky.

Meet Jim Clayton: sharecropper's son, used-car dealer, onetime bankrupt. Now he makes and sells trailer homes and is worth $265 million. And he got into the country club.

The singing mobile home salesman

By William Stern

JAMES LEE CLAYTON wasn't all that surprised when the bluebloods at Knoxville's exclusive Cherokee Country Club blackballed his membership application in 1986. Never mind that at the time he was worth $63 million as founder, chairman and chief executive of Clayton Homes, Inc., maker and retailer of mobile homes. Says Clayton: "I'm sure they said, 'No bankrupt car dealer's gonna get into our country club.' "

Eventually the bluebloods relented; in 1988 they let Clayton join their club, thereby associating themselves with a future member of The Forbes Four Hundred wealthiest Americans *(Oct. 19)*. Clayton's 29.4% stake in Clayton Homes—now the nation's largest retailer and fourth-largest manufacturer of mobile homes, with sales of $371 million—is currently worth over $250 million.

This is all self-made new money, which always makes old inherited money feel insecure. "My daddy picked cotton," says Clayton in his best down-home accent. "Momma worked in a shirt factory. My brother and I were up at 5 a.m. before school to do the milking. I dreaded holidays. Thanksgiving meant backbreaking farm work. Pickin' cotton . . . now that's hard work!"

Clayton left west Tennessee in 1953 to enroll as an electrical engineering major at the University of Tennessee. While there he bought and sold used cars through the classified ads. While still an undergraduate he opened a little used-car lot on the strip along Clinton Highway in northern Knoxville; he was soon joined by his younger brother Joe.

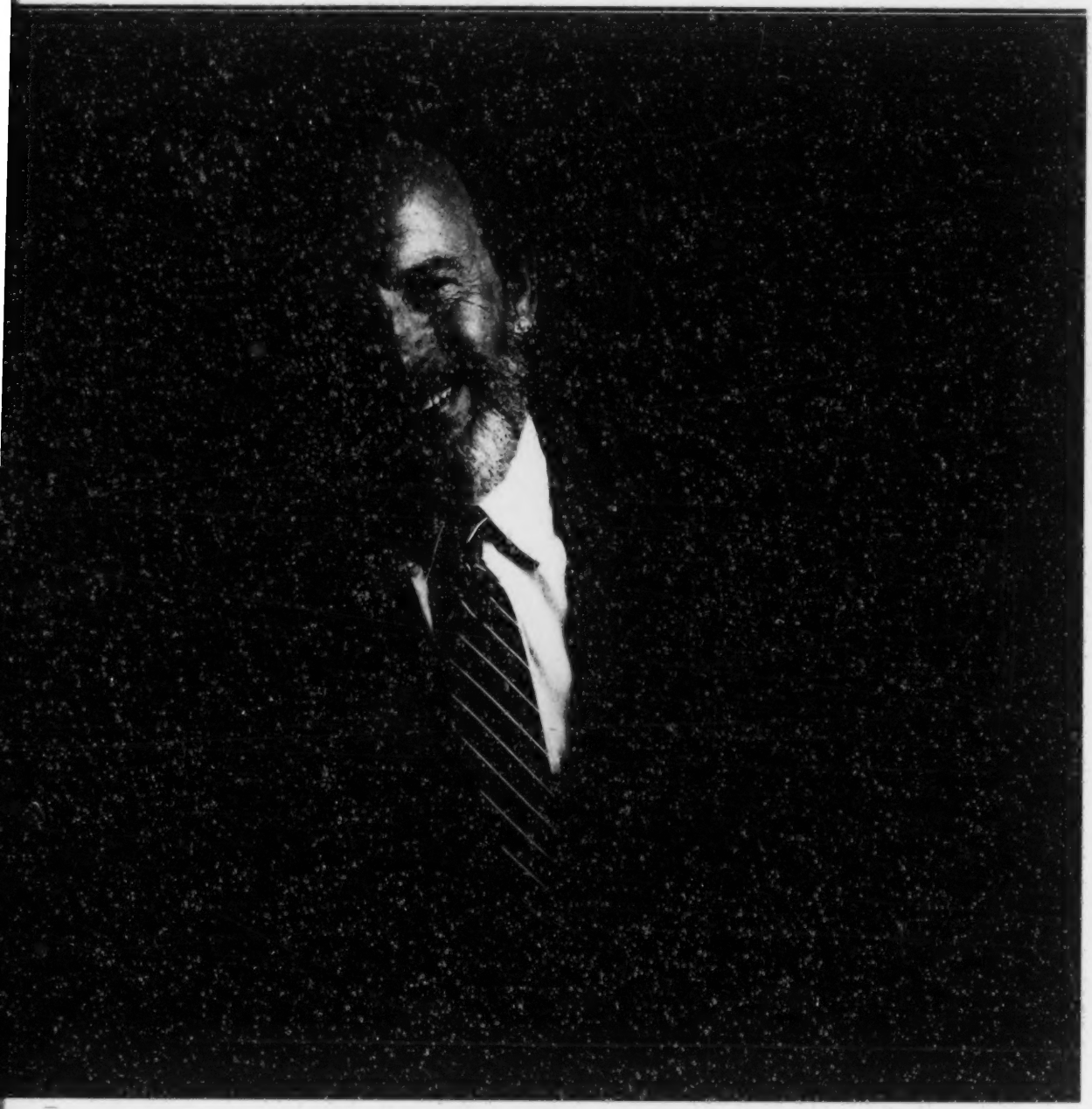
Jim Clayton in 1965, and today as chairman of Clayton Homes **Hillbilly Jim has strummed and sung with the likes of Dolly Parton.**

Then came the incident that may have weighed against him at the Cherokee Club. In 1961 Knoxville's Hamilton National Bank called in a loan, forcing Clayton's car lot into bankruptcy. The bank dissolved the company and Clayton, then 27, enrolled in law school at the University of Tennessee. But he and his younger brother soon opened a second used-car business on the same premises. Joe Clayton recalls his older brother saying at the time: "No one's gonna bankrupt me again."

Jim Clayton graduated from law school in 1964; two years later he borrowed $25,000 from a local bank and founded Clayton Homes, a mobile home retail outlet, across the highway from Clayton Motors' lot. (He eventually sold his half of the car business to Joe in 1981.)

Why mobile homes? Clayton says he'd sold two mobile homes on behalf of graduating law school classmates who were leaving Knoxville. "I just kinda slid into the business," he says.

In fact, selling mobile homes wasn't much different from selling cars—same financing, many of the same customers, most of the same prospecting and closing techniques. Moreover, the mobile home business carries higher margins than the car business and markups comparable to



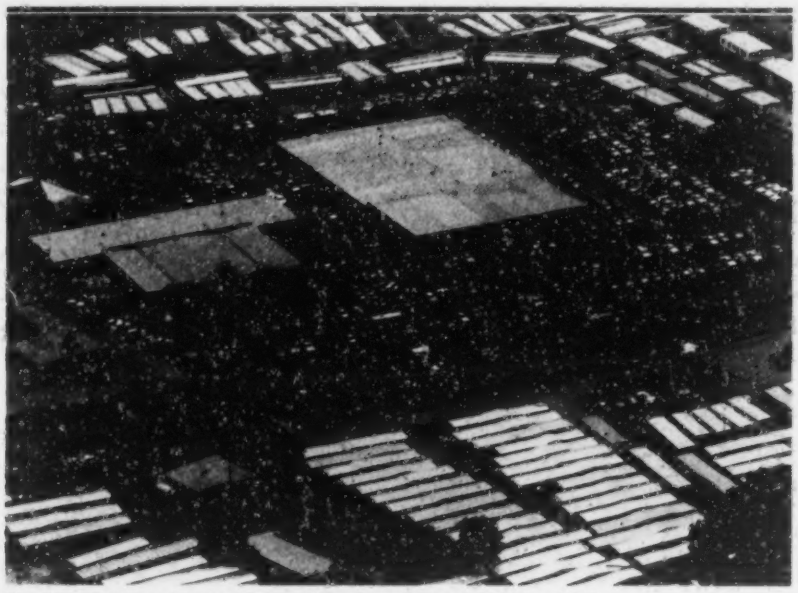
those of tract homebuilders.

Clayton had one prospecting technique no other mobile home salesman could claim. From 1960 to 1976 he was a part-time host on *Startime*, a weekly variety program on Knoxville TV. Clayton strummed the guitar, sang along with the likes of Dolly Parton and made himself into a minor celebrity in east Tennessee—priceless for a salesman.

Clayton enjoyed another advantage: The Southeast has long been the U.S.' largest market for mobile homes. By 1970, four years after he opened it, Clayton's sales lot was moving around 700 units a year.

Clayton's secret? High turnover. Clayton sacrificed margins to move homes, and the formula worked. With a simple $25,000 inventory loan, Clayton could buy 20 homes and sell them in a matter of days, often before the loan was due. Clayton moved fast: He insisted that the homes be ready to show to customers only an hour after being unloaded from the manufacturer. Fast sales work meant his inventory financing was modest in relation to the number of units sold.

As sales grew, Clayton integrated backwards and sideways. In 1970 he began manufacturing mobile homes. In 1974 he started a mortgage subsidiary to finance his sales. In June 1983 Clayton decided to cash in. He took Clayton Homes public at $3.36 a share, valuing the company at $31 million. It soon appeared he was get-



The Clayton Homes lot along Clinton Highway in northern Knoxville, 1970

"Jim sold those homes like a madman."

ting out at the top. From 1984 to 1991 industrywide mobile home shipments fell from 295,000 to 170,700 units; this year they'll probably come in at 192,000.

Yet over the same eight-year period, Clayton Homes' earnings per share grew at an annual compound rate of 23% (to $1.11 last year) as its share of the mobile home sales market climbed from 1.8% to 7.4%. Clayton Homes stock topped 27 last April, but has since backed off to 23⅝.

Up to a point, Clayton was lucky. In the early 1980s he hadn't yet entered the huge Texas market, and so avoided the massive losses suffered there by competitors Oakwood Homes and Fleetwood Enterprises as oil prices collapsed.

But the luck is backed by ability, too. Says Clayton's chief competitor, Oakwood Homes' Chief Executive Nicholas St. George: "Clayton's just plain good at what he does."

Clayton is far more vertically integrated than any of his competitors save Oakwood. When a customer walks into a Clayton-owned sales center, Clayton can make money from him in four ways. He builds mobile homes, sells them through 312 independent dealers and 130 company-owned outlets, finances them and owns 27 trailer parks ("communities," he quickly corrects a reporter) in which to park them.

In recent years, for example, Fleetwood has chased market share by slashing prices; this has squeezed Clayton's gross margins. But he has more than made that up by financing his customers' purchases. With over $882 million in loans on its books, Clayton's finance subsidiary accounted for 49% of the firm's net income of $39.3 million in 1992.

How solid are those loans? Clayton has put in place incentives to discourage lending for the sake of moving merchandise off the lot. When a Clayton sales manager recommends approval of a loan, he knows that if the loan goes bad, it comes out of his pocket. For example: A customer pays $24,000 for a financed mobile home, but cannot make his payments. Of the $2,500 typically lost, the sales manager is responsible for up to 50%.

But what happens if the loan performs? Over a typical seven-year loan period, Clayton Homes will make $500 per year per home. The sales manager shares up to half of that.

The incentives have worked so far. Clayton Homes' net chargeoffs in 1991 came to only 0.3% of average loans outstanding. By comparison, Oakwood's comparable chargeoffs ran almost three times as high.

Now 58 and wealthy beyond his wildest dreams, Clayton shows no signs of slowing down. Twice divorced and currently dating a USAir flight attendant, he logs hundreds of hours a year piloting his Cessna Citation II jet or the firm's Jet Ranger III helicopter. That hobby might give some Clayton Homes stockholders cause for reflection. As Richard Ray, Clayton Homes chief financial officer puts it, "What happens after Jim isn't around anymore?" But barring an unforeseeable accident, that's unlikely to be a problem for several more years to come.

The mobile home community

Company	Recent price	Latest 12-month EPS	P/E	Yield %	Sales ($mil)	Profit margin	5-year ROE
Clayton Homes	23⅝	$1.13	20.9	0.0%	$371	8.9%	17.2%
Champion Enterprises	4⅜	-0.09	NM	0.0	270	-0.2	-16.0
Fleetwood Enterprises	33	1.86	17.7	2.8	1,401	2.2	12.1
Oakwood Homes	14½	0.91	15.9	0.6	163	5.4	7.1
Skyline	16⅛	0.52	31.0	3.0	328	1.6	6.8

NM: Not meaningful.
Source: Value Line via Lotus One Source.

Mobile home shipments shrank 42% from 1984 to 1991, falling from 295,000 to 170,700 homes. Over the same time frame, Clayton compounded its earnings per share 23%, leaving its competitors behind.

Your favorite charity may be better at collecting money and fudging the accounting rules than at getting the money out to worthy causes.

The accounting games charities play

By Roula Khalaf

LAST YEAR St. Labre Indian School, an Ashland, Mont. Catholic charity that runs schools on Indian reservations, collected nearly $17 million from the public. It spent over $5 million to raise that amount. Thus only 68 cents of every dollar raised actually made it to the classrooms.

But to make the operation look more efficient, the charity reported it raised only $14.6 million and spent only $2 million on fundraising. Through bookkeeping magic, the group's ratio of charitable spending to total expenses suddenly jumped from 66% to 76%. That higher ratio looks better when hitting up potential donors for contributions.

Was St. Labre bending the rules? Not really. Under some obscure guidelines set by something called the National Catholic Development Conference, the school may reduce its reported fundraising costs by the amount raised from *new* donors—$2 million in St. Labre's case.

St. Labre isn't unusual. Hundreds of tax-exempt organizations that have turned charity into a huge business use similar accounting practices. Nonprofit organizations took in $125 billion last year, with 88% of that contributed by individual donors. Yet, unlike for-profit companies, which must adhere to fairly strict accounting rules, charities are subject only to the vaguest of rules. As a result, donors often can't tell if a charity is efficient at collecting and disbursing money for worthy causes or just good at cooking its books.

"Charities are toying with the credibility and integrity of their financial statements," says Kenneth L. Albrecht, head of the National Charities Information Bureau, a New York-based industry watchdog. "We have an epidemic."

Adds Russy Sumariwalla, a charities accounting expert who heads United Way International: "The system is not designed to honestly disclose to the donor the real picture."

The basic problem: The people who run charities like to be able to show most of the money they raise goes to fund the worthy programs their donors like—saving dolphins, say, or promoting health awareness. To make their reported program expenses as high as possible, they try to make the amounts spent on fundraising, highly paid administrators and other overhead as low as possible.

Until 1987 charities didn't have much leeway when reporting their fundraising costs to state governments. A rule followed by most auditors held that if the primary purpose of an activity was to raise money, it had to be accounted for as a fundraising expense. Period.

That changed in 1987. Several of the country's biggest charities—among them the American Lung Association and the March of Dimes—convinced the American Institute of Certified Public Accountants to write a new rule and state regulators to accept it. This one says that part of fundraising costs can be classified as "educational" costs, as long as the charity can prove the audience is specifically interested in its cause and the message motivates the recipient to act rather than just contribute.

That's the theory. The practice? Practically every charitable solicitation now comes with a newsletter, sticker or some other "educational" material that lets the charity's execu-

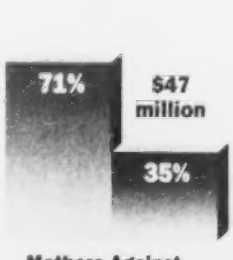
Accounting magic

Here's what a few charities that take full advantage of the current accounting rules would be spending on charity if they couldn't allocate a portion of their fundraising costs to educational programs.

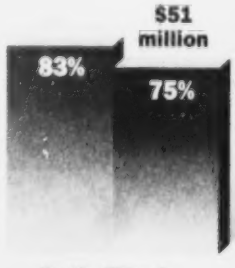
1991 program expenses as a percent of total expenses

Reported Adjusted

Numbers in green indicate direct public support



Mothers Against Drunk Driving



Cystic Fibrosis Foundation (1990 data)

Sources: Form 990, audited financial statements, NCIB reports

tives deflate their reported fundraising costs and inflate the percentage they disburse to the programs they're supposed to support. Says charities watchdog Albrecht: "Public education has become the toxic dump of charity accounting."

Take $3 million (direct public support 1991 fiscal year) American Heart Disease Prevention Foundation. It says it spent 29% of its expenses on charity last year—an unusually small percentage. Eliminating education expense, the amount spent directly on charity drops to just 5%. Most of the rest went for fundraising.

Why are those costs so high? One clue: Heart Disease until recently was a client of Watson & Hughey (now Direct Response Consulting Services), an Alexandria, Va. direct mail outfit with a history of charging little charities big fees. Attorney Errol Copilevitz, who represents Watson & Hughey, says his client's fees are "customary and reasonable."

American Heart has hired a new fundraiser, Houston-based TeleSystems Marketing. But this firm may prove to be no more helpful. Run until recently by a convicted felon (and now by his wife), TeleSystems was sued for fraud in 1990 by the Illinois Attorney General. Illinois alleges the telemarketer charged National Children's Cancer Society, a St. Louis-based charity, $8.3 million for raising $9 million. National Children claimed one-third of this fundraising cost was for "educational" materials. Copilevitz, who represents TeleSystems and National Children as well, says there is no law against high fundraising expenses.

Big charities play the education allocation game, too. Consider the American Lung Association, which uses a sophisticated sweepstakes billed as an "old fashioned" raffle. The charity assigns 20% of the cost of its sweepstakes mailings to education.

Where is the "educational" material? A spokesperson for the charity notes that on the back of each sweepstakes ticket is a picture and text about people helped by donations.

Does this information serve any purpose other than making you want to enter the sweepstakes? The American Lung Association people and their auditors say it does, and under the current accounting rules, their judgment usually is all that matters.

"When donors call us," says Steve Arter, a senior financial investigator specializing in charities at the Pennsylvania Attorney General's office, "we'll say such and such a charity spends 80% [of the money it raises] on programs. But what that doesn't tell you is that the charity may be spending 2 cents on research and the remaining 78 cents on what you're holding in your hand."

Yielding to pressure from state officials like Arter, the American Institute of Certified Public Accountants is studying ways to tighten the rules on what can be charged to education. A decision is expected next year.

Meanwhile, some charities are turning for guidance to a book coauthored by Robert Frank, a Washington, D.C. area accountant who advocates the "physical units" method of allocating costs. What Frank means is counting words. So if a charity spent $100,000 to mail a 500-word solicitation attached to a 5,000-word "educational" newsletter, 90% of the cost could be considered money spent on programs.

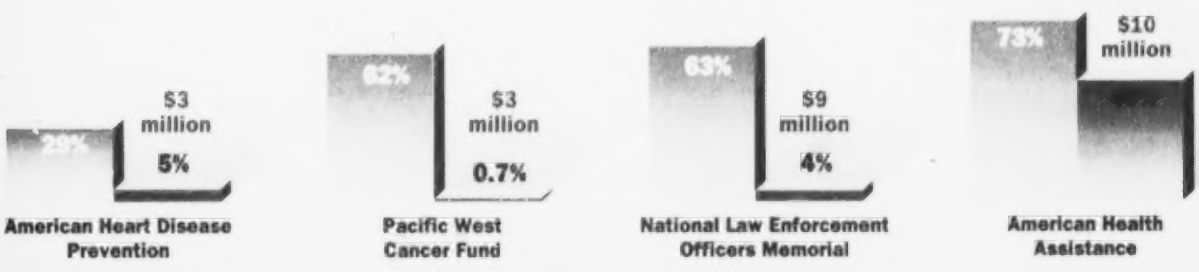
"Word counting is theoretically appropriate," says Richard Larkin, a director at Price Waterhouse and head of an AICPA task force on nonprofits. "But it's subject to abuse by charities that pad the mailings with fluff."

A lot of the charities' expenses for administrative costs end up as program costs, too. "We're seeing charities that report administrative costs of only 1% or 2%," says Pennsylvania charities investigator Arter. "It's rare now to see anyone reporting costs over 5%. It's not that they've become any more efficient, but they're writing off the costs to programs, including legal and accounting fees."

Compassion International, an agency that arranges sponsorship of children, raised over $35 million from the public in fiscal 1991. Compassion books nearly half of its accounting costs under spending on its programs. Says Scott Noll, one of Compassion's internal accountants: "There are no real standards for what can be included in programs. Each organization is flexible in what it calls 'programs.' "

More headaches arise in accounting for donated goods. Charities can record the fair market value of goods received as contributions, and then as program costs unless the goods are just passed on to other charities. But that rule is often abused.

In August Connecticut and Pennsylvania filed lawsuits accusing four charities of booking worthless goods at inflated prices and passing them on to other charities, which put them on their books at the same inflated values. The states' attorneys general charged that Knoxville, Tenn.-based Cancer Fund of America falsely claimed in 1990 that it had spent $7.4 million on "patient services." But of that amount, $2.5 million was the value asserted by the charity of unsalable vegetable seeds CFA had allegedly purchased for a mere $25,462 and passed on to another relief organization, which in turn donated the seeds



to a South Dakota Indian reservation.

Another of the charities under investigation by Connecticut is Feed the Children, based in Oklahoma City. Out of total program expenses of $102 million last year, this charity recorded $86 million as the value of in-kind gifts. Investigators are looking into whether Feed the Children reported the value of used books it passed on to other charities to make its ratio of expenses to program spending look more efficient. John Schantz, Feed the Children's controller, says he isn't aware of any probe.

In another example of the curious ties that often pop up in the charity industry, it turns out that a Washington, D.C. accountant named Bryan Brown, of now defunct Brown & Co., audited the books of all four charities sued by Connecticut and Pennsylvania. Brown, who declined to talk to FORBES, now runs a former client, the American Indian Relief Council in Rapid City, S.D.

Here's yet another twist: Many charities sell merchandise—gifts, cards, T shirts and the like—to supplement their donations. The cost of producing those products can be considered a program expense—if the products are "program-related."

The National Wildlife Federation, for instance, considers the production and distribution of Christmas cards and toys with conservation themes a part of its charitable program activity. "Getting people excited about nature is exactly what our mission is all about," says Lynn Bowersox, National Wildlife's media relations manager.

The wildlife group has no qualms about adding around $12 million a year in merchandise production costs to its reported expenditures on charitable programs. But the National Charities Information Bureau, which evaluates charities, thinks this is one accounting gimmick too many. Excluding these merchandise costs, National Wildlife spent 64%, not 69%, of its total expenses on charitable programs in fiscal 1991.

Some charities are awash with cash but hold back charitable spending. Shriners Hospitals for Crippled Children, for example, took in revenues of $500 million last year, but spent less than 50% on programs, tucking most of the rest away for investment. Shriners has been criticized by the Better Business Bureaus' philanthropic advisory service for not spending enough of its income on programs.

And some charities use multiple accounting gimmicks to make program expenditures look impressive. Example: World Vision, the Christian charity that provides health, disaster and poverty assistance around the world.

World Vision claims 80% (or $187 million) of its total expenditures goes to charitable activities. The figure is inflated several ways. First, about $73 million is goods, not cash, that were passed on to other charities or its independent field offices. Second, nearly $9 million is booked as a public awareness and education expense incurred with fundraising costs; charity industry watchdogs at the NCIB believe all that $9 million should be reported as fundraising expenses.

We're down to actual program expenses of $105 million. But only $4 million of that went to evangelism in the U.S., and another $97 million was actually sent to World Vision's international headquarters for charitable uses. And not even that much made it to the charity's programs. Nearly 6% of every dollar received by headquarters goes to administration; figure another 3% is taken out for administration in the organization's Third World offices.

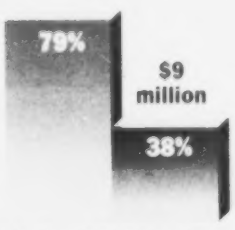
Bottom line: Of the $187 million World Vision says it spent last fiscal year, only $92 million was spent directly on the group's various charitable programs.

Some modest protection for donors is on the way. The Financial Accounting Standards Board, the country's chief rule-setter, is finally getting ready to issue two proposals based on its eight-year effort to write better rules for nonprofit organizations. But don't hold your breath. The FASB proposals deal mostly with presentation and measurement, as opposed to how charities should be allocating costs.

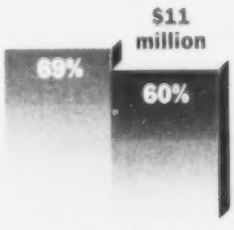
If better accounting from the charities is on the horizon, we may have the Internal Revenue Service's growing interest in the industry to thank. This summer the IRS went to Tax Court to defend its September 1990 decision to rescind the tax exemption of the United Cancer Council, a former client of direct mail fundraiser Watson & Hughey. The charity claimed that 43% to 55% of its direct mail expenses went to public education. But the IRS rejected the charity's accounting and found that only about 4% of UCC's expenses went for exempt purposes. The IRS deemed that percentage insufficient and concluded that the charity was in effect working for the benefit of Watson & Hughey, not cancer patients. A court decision isn't expected before next year, but lots of charities are keeping their eyes glued to the case.

In the meantime, if you're interested in looking into the finances of charities, get a (free) copy of the National Charities Information Bureau's *Wise Giving* guide, which evaluates 400 charitable organizations; the NCIB also issues full reports on individual charities. (Write to NCIB, Department 200, 19 Union Square West, New York, N.Y. 10003.)

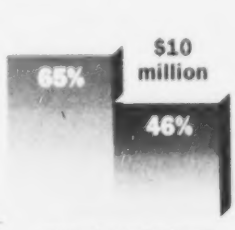
But to really find out where the money goes, put aside your checkbook, pull out your calculator, and ask the charities you're interested in for their annual reports and audited financial statements. A charity that won't send you its financial report isn't worth your money. ■



National Children's Cancer Society



Humane Society of the U.S.



Help Hospitalized Veterans (1990 data)

Evaluating fundraising efficiency

By Roula Khalaf and William Heuslein

How do the country's charities stack up against one another? In an important sense, the question has no answer. Who's to say whether the health consciousness dispensed by the American Lung Association is superior to the dolphin consciousness disseminated by Greenpeace? But from a financial point of view, some comparisons can be made.

Experienced donors usually try to evaluate fundraising efficiency by looking at the percentage ratio of fundraising cost to direct public support—that is, how much a charity had to spend to raise $1 of public contributions. The lower the ratio, the more efficient the charity at distributing money to worthy causes.

In evaluating 100 U.S. charities this year, FORBES is also taking account of the average gift size, because it costs more on average to raise a smaller gift. Amnesty International's 29% fundraising cost percentage is on the high side if compared with all other charities. But it's not out of line with those with a similar average gift size of $25 to $50. (The average gift size method is based on work done by Bill Levis at the Nonprofit Management Group at Baruch College, City University of New York.)

To come up with the figures for the table, FORBES consulted the charities' 1991 Internal Revenue Service filings (Form 990), and audited financial statements. We then asked charities to estimate the total number of gifts received during the year from individuals, corporations and foundations. That gave us the average fundraising cost per gift and average gift size figures. The fundraising cost percentage is the percentage ratio of fundraising costs to direct public support.

As explained in the accompanying story, charities often understate fundraising costs by charging a portion to "educational" programs. We used reports on individual charities published by the National Charities Information Bureau, which adjusts fundraising costs based on a review of the so-called educational materials the charities send out with their fundraising solicitations.

Where the NCIB didn't make adjustments or didn't evaluate the charities, FORBES examined the notes in charities' financial statements to find out which organizations charge part of their fundraising costs to educational programs. If the educational amount turned out to be more than 40% of the total cost, we made an adjustment to keep it at no more than 40%. Why? Nonprofit experts FORBES consulted say 40% is a reasonable cutoff point. We applied that ceiling to ten charities on this list.

For example, the Arthritis Foundation claims that 70% of the cost of certain events isn't fundraising expense but rather money spent on its educational programs. This yields a fundraising cost percentage of 17%. By accepting only 40% of the cost as education, FORBES arrived at a fundraising cost percentage of 23%.

It's best to compare charities within groups. The median fundraising cost is what's reasonable for the group. The fundraising cost per gift column shows how much of your gift goes to fundraising.

Many large groups are not represented. Some, like the American Cancer Society, couldn't provide FORBES with their total number of gifts. Others, like the YMCA, don't consolidate their numbers.

It costs more to raise a smaller gift. So compare charities within average gift size groups.

A new evaluation tool

Direct public support ($mil)	Organization	Fund-raising cost per gift ($)	Fund-raising cost %
	Average gift size over $2,500		
136	Institute of International Education	747.17	0.9
33	Museum of Fine Arts (Boston)	192.02	5.6
28	Jewish Communal Fund of New York	100.56	0.3
18	Museum of Modern Art (NY)	562.14	6.5
14	American Museum of Natural History	230.12	8.1
10	Field Museum of Natural History	178.71	6.9
9	Population Council[6]	2,452.17	2.8
8	Jewish Board of Family & Children's Services	257.26	5.9
5	National 4-H Council	380.17	12.4
5	Walker Art Center[7]	432.66	10.6
5	Devereux Foundation	497.95	16.1
2	Girl Scouts of the USA[5]	652.51	22.9
2	Big Brothers/Big Sisters of America[5]	808.35	19.3
2	Eleutherian Mills-Hagley Foundation (Museum)	775.32	28.0
2	Catholic Charities USA[1,5]	519.66	20.2
	Median		8.1

[1]Fiscal year 1990. [2]Fiscal year 1992. [3]Fundraising costs adjusted (NCIB). [4]Fundraising costs adjusted 60% to fundraising (Forbes). [5]National office, exclusive of affiliates. [6]Average gift is $87,600. [7]Includes indirect public support. [8]Includes membership dues and membership development costs. [9]Excluding $13 million of endowments, grants and bequests. [10]Direct mail only, total public support equals $100 million. [11]Fundraising cost includes $3 million in donor development costs. [12]From audited financial statements, including combined and consolidated. [13]From unaudited combined and audited financial statements.

THE FORBES/BARRA WALL STREET REVIEW

BY ERIC S. HARDY

Wall Street is living up to its tradition of not performing well during periods of uncertainty. But the bulls are saying that once the election is over—no matter the outcome—stocks will pick up again. Basis of their case: Banks and money market funds don't even offer positive returns after taxes and inflation.

Investors who like stocks that are out of favor might consider two tarnished blue chips recommended by William LeFevre of Tucker Anthony and Sutro & Co.: IBM and General Motors. LeFevre says both offer excellent opportunities for dividend income and capital gains. IBM is paying a 6% yield—more than some utilities—and LeFevre feels the dividend is safe. "IBM is still the dominant computer maker because of its overseas markets," he says. LeFevre also likes the yield on GM (5%) and the fact that the stock is down 30% from its high set earlier this year.

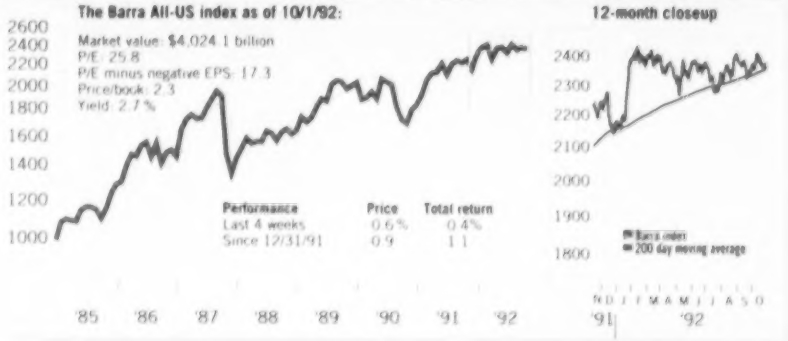
Special focus

Over the past year, two out of every three initial public offerings had a first-day close higher than the offer price. But a quick start does not guarantee a good finish. The table shows the performance to date (measured from offering price) of the ten new issues of the last 12 months that had the biggest first-day gains.

IPOs too hot to handle

Company	Gain — first day	Gain — 9/30
Radiation Care	106%	-50%
Lifecell	94	68
Alteon	92	-33
Synopsys	75	64
Olympic Finl Ltd	75	104
Grand Casinos	75	205
Target Therapeutics	71	31
Megacards	70	-30
Defense Software/Sys	69	60
LaserSight	68	133

The overall market



Closeup on the market

Index or investment	2-week change	% change from 1 year	% change from 5-year high
Barra All-US index	-1.1%	7.8%	-3.4%
S&P/Barra Growth index	-1.9	11.0	-3.2
S&P/Barra Value index	-0.3	11.7	-2.3
Dow Jones industrials	-1.8	9.0	-4.7
S&P 500	-0.9	8.3	-2.1
NYSE	-1.0	8.0	-2.1
Nasdaq	-1.6	11.1	-10.3
Amex	-2.7	0.5	-10.5
EAFE	-1.4	9.3	-26.1
CRB index[1]	-0.3	7.0	-26.0
Gold[2]	-0.1	-2.9	-30.8
Yen (per $U.S.)	-3.7	-10.1	-27.0
Oil[3]	-2.0	-3.5	-46.9

The best and worst performing stocks[4]

Best	Price	2-week change	1992 EPS[5]	Worst	Price	2-week change	1992 EPS[5]
Alexander's	28 1/8	39%	NA	Home Nutritional Svcs	7	-48%	$0.99
DSC Communications	12	33	$0.06	Gensia Pharmaceuticals	19 1/2	-48	-1.21
Bertucci's	17 1/2	32	0.59	Computervision	5 1/8	-45	NA
Preferred Health Care	16	31	0.43	Total Pharmaceutical Care	12	-43	0.89
Bernard Chaus	9 1/8	29	0.38[6]	Exabyte	14	-41	2.16

The best and worst performing industry factors[7]

Best	2-week change	Since 12/31/91	Worst	2-week change	Since 12/31/91
Life insurance	9.8%	6.8%	Beverages	-8.9%	-8.7%
Real estate	9.2	-10.5	Electric utilities	-8.2	-8.8
Trucking	7.5	7.9	Gas utilities	-6.7	-1.4
Property & health insurance	6.6	13.1	Misc mining & metals	-5.9	-4.3
Household products	4.7	7.5	Drugs	-5.7	-20.7

Note: Data for period ending 10/1/92. The Barra All-US index consists of all publicly traded common stocks for which price quotations are available and ordinary shares of foreign stocks trading on U.S. markets. ADRs, REITs and closed-end funds are excluded. [1] Total return of a portfolio of more than 150 large-capitalization stocks that has high historical earnings growth and has predicted above-average earnings growth. [2] Total return of more than 300 large capitalization stocks characterized by low price-to-book ratios, high yields and low price-to-earnings ratios. [3] A dollar-denominated capitalization-weighted index of more than 1,000 stocks from Europe, Australia, New Zealand and the Far East. Source: Morgan Stanley Capital International Perspective. [4] Index of 21 commodity futures. [5] Knight-Ridder Financial Information. [6] During the last two weeks. [7] Estimate. Source: Institutional Brokers Estimate System, from IBES, Inc. [8] Shows return to the industry factor after controlling for other influences, including company size, value and growth characteristics. Multi-industry firms have proportional contributions in two or more groups. [9] 1993 estimate. Principal source: Barra, Inc., Berkeley, Calif.

NEW ISSUES REVIEW

BY SCOTT DeCARLO

The biggest new issues[1]

Company/business	Exchange	Offer date	Offer price	Recent price	Offering ($mil)	Lead underwriter	Performance to date absolute	Performance to date rel to mkt[2]
Equitable Companies/insurance	n	7/15/92	9	8⅛	$392	Goldman, Sachs	-10%	90
Computervision/computer equip & svcs	n	8/14/92	12	6¼	300	Lehman Brothers	-48	52
Sunbeam-Oster/small appliances	n	8/18/92	12½	13⅜	250	Merrill Lynch	7	108
Fleet Mortgage Group/mortgage banking	n	7/31/92	23	20	191	Goldman, Sachs	-13	88
Rexnord/bearings	n	7/1/92	17	15¾	156	DLJ	-8	91
Gtech Holdings/computerized lottery sys	n	7/22/92	17	26	145	DLJ	53	150
USX-Delhi Group/gas pipeline	n	9/24/92	16	15⅛	144	Lehman Brothers	-4	96
Bradlees/department stores	n	7/1/92	13	13⅛	143	Merrill Lynch	7	105
Enron Liquid Pipeline/gas pipeline	n	7/30/92	23	26⅛	130	Lehman Brothers	17	119
John Alden Financial/insurance	n	9/25/92	15	15	110	First Boston	0	99

Performance update

Although 1992 will go down on the books as a record year in the amount of capital raised in the new issues market, the market's pace slowed considerably in the last quarter. Securities Data Corp. of Newark, N.J. reports that through the first nine months of 1992, 335 new issues raised $16.7 billion, up from 195 issues raising $8.7 billion during the same period last year. But the third quarter of 1992 was slower than the third quarter of 1991. September saw only 28 initial offerings, the lowest monthly total since March 1991.

The new issues market seems unlikely to catch a second wind in the last quarter of this year. One bearish sign is all the postponements. Revlon, for instance, in May announced its intention to raise $209 million, with an offering of 11 million shares at $19 a share. Even after reducing the offering price from $15 to $14, Merrill Lynch couldn't drum up enough buy orders to make the deal fly. Other offerings postponed since last spring include Life Partners Group. First Boston originally priced the issue at $17 but was unable to sell it, even after cutting the price to $15. Goldman, Sachs didn't have much better luck in its attempt to take Clark Oil & Refining public, despite reducing the price from $16 to $14 a share.

The best new issues[1]

Company/business	Offer price	Offering ($mil)	Lead underwriter	Performance to date absolute	Performance to date rel to mkt[2]
Northern Springs/bottled water	5	$5	Network Financial	140%	238
Eagle Hardware & Garden/hardware stores	14	42	Montgomery Secs	138	237
Pyxis/leases medical equipment	14	56	Merrill Lynch	105	202
Zoll Medical/medical equipment	10	21	First Boston	103	202
Stratacom/telecomm equipment	7	18	Montgomery Secs	71	170

The worst new issues[1]

Company/business	Offer price	Offering ($mil)	Lead underwriter	Performance to date absolute	Performance to date rel to mkt[2]
Computervision/computer equip & svcs	12	$300	Lehman Brothers	-48%	52
Bestop/auto parts	9	8	Dain Bosworth	-29	71
Ezcony Interamerica/consumer electronics	7	11	First Equity	-29	72
First Pacific Networks/telecomm svcs	9	45	Nomura Secs	-25	74
Xxsys Technologies/measuring devices	3¼	6	Thomas James Asoc	-25	76

The most active investment bankers

Underwriter	Total offerings	Total raised ($mil)
Goldman, Sachs	25	$3,890
Morgan Stanley	27	2,814
Lehman Brothers	32	2,613
Merrill Lynch	21	2,407
First Boston	24	1,817

Industries going public

Industry	Total offerings	Total raised ($mil)
Manufacturing	187	$9,188
Services	67	2,666
Retail	43	2,115
Health care	32	2,102
Insurance	12	1,237

Note: This report covers initial public offerings of common equities with offer date of 7/1/92 to 9/30/92, offering price of $2.50 or more and offering value of $5 million or more. Closed-end funds, limited partnerships, and ADRs (American Depositary Receipts) of corporations already traded in foreign countries are excluded, as are REITs and spinoffs. [1]Last quarter. [2]The ending value of $100 invested in the stock, divided by the ending value of $1 invested in the market. [3]Latest 12 months. Source: Securities Data Co.